United States Patent Office
Mr. Allen R MacDonald
Washington, DC 20231

December 11, 2001

Dear Mr MacDonald,

We have an interest in the area of electronic sales tax collection and have seen that J. Taricani has a patent pending in the PTC (copy enclosed) and is pending in the US. The claims he describes are the subject of a National Tax Association meeting and Reports published in November 19, 1998 copies are enclosed. While the exact wording is not the same the idea concept has been laid out here and in other patents already allowed. Specifically, the taking of tax information from the point of sale, computing taxes and sending the information and payment to a central location, broker, third party etc. is not new.

Before more patents are issued in a crowded space please read the enclosed and pass this to the appropriate agent.

nta

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1 of 3

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PUBLISHED INTERNATIONAL APPLICATION

(11) **WO 01/08064** (13) A1

(21) PCT/US00/19551

(22) **26 July 2000 (26.07.2000)**

(25) ENG (26) ENG

(31) 60/145,270 (32) **26 July 1999 (26.07.1999)** (33) US

(31) 60/148,285 (32) **11 August 1999 (11.08.1999)** (33) US

(31) 60/165,657 (32) **16 November 1999 (16.11.1999)** (33) US

(43) 01 February 2001 (01.02.2001)

(51)[7] G06F 17/60

(54) COMPUTER-BASED SYSTEM FOR SIMPLIFICATION OF TAX COLLECTIONS AND REMITTANCES FOR INTERNET AND MAIL ORDER COMMERCE

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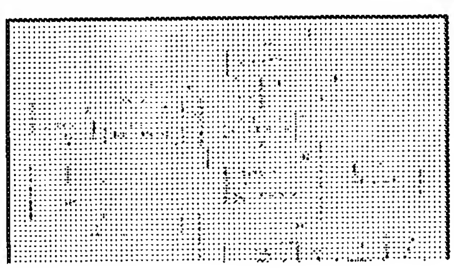
(81) AL, AM, AT, AU, AZ, BA, BB, BG, BR, BY, CA, CH, CN, CU, CZ, DE, DK, EE, ES, FI, GB, GE, GH, GM, HR, HU, ID, IL, IS, JP, KE, KG, KP, KR, KZ, LC, LK, LR, LS, LT, LU, LV, MD, MG, MK, MN, MW, MX, NO, NZ, PL, PT, RO, RU, SD, SE, SG, SI, SK, SL, TJ, TM, TR, TT, UA, UG, US, UZ, VN, YU, ZW ; AP (GH, GM, KE, LS, MW, MZ, SD, SL, SZ, TZ, UG, ZW); EA (AM, AZ, BY, KG, KZ, MD, RU, TJ, TM); EP (AT, BE, CH, CY, DE, DK, ES, FI, FR, GB, GR, IE, IT, LU, MC, NL, PT, SE); OA (BF, BJ, CF, CG, CI, CM, GA, GN, GW, ML, MR, NE, SN, TD, TG)

Abstract



An effective and efficient system for recovering tax revenue. One implementation is to recover tax revenue currently not being recovered by storing data in a database (2) indicating

interstate sales transactions (7) on which a seller does not collect a designated tax, such as a ***sales tax***. This database (2) is part of a computer network (1) that organizes and stores the data in the database (2) and automatically sends out tax due notices (S3) to purchasers (5) when data in the database (2) indicates that an interstate sale has taken place and no designated tax has been collected from the purchaser (5) by the seller. This database (2) can also be updated to reflect payment of the tax indicated in the tax due notice (S3), and can automatically remit appropriate revenues to a revenue agency (4) when the tax due notice has been paid (S4). One implementation is also collecting a tax on all interstate sales transactions (7) by using a central facility that assists remote sellers in knowing what rate to employ for any given transaction and receiving and distributing collected taxes to the appropriate revenue agencies (4).

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1 of 3

CLAIMS:

1. A method of tax collection and remittance, comprising steps of:

sending a sales information message regarding a taxable event from a remote seller to a central facility, said sales information message identifying a tax jurisdiction of a participant in said taxable event, said remote seller not having a nexus in said tax jurisdiction;

identifying tax rate information for the tax jurisdiction;

providing the tax rate information from the central facility to the remote seller for the tax jurisdiction of the participant;

calculating a tax due from the tax rate provided in said providing step; and

collecting a tax payment in an amount calculated in the calculating step.

2. The method of Claim 1, wherein:

said collecting step includes receiving the tax payment and forwarding the tax payment from the remote seller to the central facility.

3. The method of Claim 2, further comprising a step of:

remitting said tax payment from said central facility to a revenue agency responsible for collecting taxes for said tax jurisdiction.

4. The method of Claim 3, further comprising the steps of:

registering said remote seller with said revenue agency, including

providing remote seller information to said central facility, and

said central facility communicating the remote seller information to the revenue agency and receiving a tax payer identification for said remote seller from said revenue agency.

5. The method of Claim 4, further comprising:

registering said remote seller in another tax jurisdiction so that if said remote seller collects taxes from another participant in a future taxable event, the remote seller is registered to remit taxes collected on behalf of the another tax jurisdiction.

6. The method of Claim 1, wherein:

said sending step includes sending said sales information to said central facility over an Internet connection, a communications interface for said central facility being an Internet website.

7. The method of Claim 1, wherein:

These enclosed documents were distributed to the public in a meeting on 11-19+20 1998 see page 2

National Tax Association Communications And Electronic Commerce Tax Project

CALENDAR OF EVENTS

Date	Event	Location
Monday 8/18/97	Operating Committee meeting MINUTES	Salt Lake City, UT
Thursday 9/4/97	Steering Committee meeting MINUTES	Gannett Co. Inc. 1100 Wilson Blvd. Arlington, VA
Wednesday 11/12/97	Steering Committee Meeting and Public Working Session **Advanced Reading - paper by Kendall Houghton** AGENDA Memorandum dated 11/24/97 containing revised schedule of Project activities and Meetings. MEMO	Drake Hotel 140 E. Walton Place Chicago, IL 60611
Wednesday 2/4/98	Steering Committee Meeting AGENDA MINUTES Working Group Members	La Jolla Marriott Hotel La Jolla, CA
Saturday & Sunday 3/14/98 - 3/15/98	Operating Committee Meeting	Alexandria, VA

Thursday & Friday 4/23/98 - 4/24/98	Steering Committee Meeting MINUTES Description of NTA Tax Project Working Groups' Agendas for Future Efforts	Salt Lake City, UT
Wednesday & Thursday 7/22/98 - 7/23/98	Steering Committee Meeting DETAILS AGENDA	Las Vegas, NV
Thursday & Friday 11/19/98 - 11/20/98	Steering Committee Meeting AGENDA MINUTES	Washington D.C.
Thursday & Friday 1/21/99 - 1/22/99	Steering Committee Meeting DETAILS AGENDA MINUTES	(Crystal City) Arlington, VA
Monday & Tuesday 3/29/99 - 3/30/99	Steering Committee Meeting DETAILS AGENDA	Washington, D.C.
Thursday & Friday 7/8/99 - 7/9/99	Steering Committee Meeting DETAILS **Update 6/22/99**	Snowbird Resort, Utah (outside Salt Lake City)

MEETING 11/18/1998

NTA Communications and Electronic Commerce Tax Project

Administrative Simplification Subcommittee

Index of Resource Documents for Steering Committee Deliberations

I. DEFINING OUR OBJECTIVE OF "TOTAL SIMPLIFICATION."

Document	***Tab***
OD-5: Preliminary Statement of Direction Achieving Simplification and Uniformity in State and Local Sales And Use Tax Administration; 1/14/98	A
OD-6: Business Group's Discussion Outline (including the definition of the concept "total simplification"); 1/23/98	B
Tabulation of responses from members of the Steering Committee ranking their highest priorities for administrative simplification	C

II. PROGRESS REPORTS OF THE ADMINISTRATIVE SIMPLIFICATION SUBCOMMITTEE.

Document	***Tab***
OD-12: Progress Made To Date By The Task Force on Simplified Filing; 4/12/98	D
Informal "Scoresheet" of progress on items constituting the business group's "Total Simplification" agenda; 11/18/98	E

11/18/98

Index of Resource Documents for Steering Committee Deliberations – cont.

III. CONCEPT PAPERS DISCUSSING THREE ALTERNATIVE APPROACHES TO ADMINISTRATIVE SIMPLIFICATION.

Document	***Tab***
Report of meeting among state tax administrators in Chicago on 10/29/98 to discuss impact of Simplification on governments	F
Concept #1: Base State Administration	G
Concept #2: Hybrid Base State	H
Concept #3: Real Time Administration	I

IV. REACTIONS TO CONCEPT PAPERS

Document	***Tab***
Feedback report on administrative alternatives prepared by K. Silverberg; 11/12/98	J
Summary evaluation of alternative simplification approaches prepared by H. Duncan; 11/16/98	K

V. OTHER RESOURCE MATERIALS

Document	***Tab***
Report of sales tax rates and vendor discount rates, state-by-state, as of 7/1/98, from the FTA website.	L

F

National Tax Association Communications and Electronic Commerce Tax Project
Administrative Simplifications

Discussion of State Tax Administrators
October 29, 1998

This memo summarizes the meeting of government tax agency representatives in Chicago on October 29, 1998, to discuss recent activities of the National Tax Association Communications and Electronic Commerce Tax Project, especially three approaches to tax simplification—referred to herein as the "real time," "base state" and "hybrid" approaches—that are currently being considered. Each of the approaches is described more thoroughly in the concept papers distributed earlier. The focus of this memo will be the attendees' discussion and evaluation of the approaches.

Tax administrators from the following states were in attendance: Minnesota, Illinois, Michigan, Iowa, New Hampshire, Oklahoma, South Dakota, North Dakota, North Carolina, Idaho, Washington, New Jersey, Maryland, Kansas, Rhode Island, Ohio, and Florida.

Background Discussion

Before the group began discussing the three approaches, presentations about the status of the overall work of the NTA Project were made. Dan Bucks began the presentations by pointing out that the overall theme of the Project is to modernize the state sales tax structure, by tearing it out of its roots in the 1930s and bringing it more into line with the way business is conducted at the millenium. In working toward this goal with private industry, the parties can generally expect to trade off tax simplification for expanded reporting.

Dan then reported that, based on the Project's Tax Rate Subcommittee, the Project Steering Committee, including representatives of local governments, had agreed to industry's request for one rate per state covering all commerce, not just remote sales or electronic commerce. He further reported that the Tax Base Subcommittee is currently discussing use of a single list of items defined uniformly that can be considered taxable or non-taxable by the states. The definitions would be in a listing that would be similar to a master list employed by the United Nations. The subcommittee is also exploring the development of means of verifying the identities of remote purchasers.

Harley Duncan reported that the Sourcing Subcommittee is currently discussing means of sourcing sales, including sales for which the location, or even the identity, of the purchaser is not readily known. A system currently being considered would operate under four principles: (1) Sales would still be sourced to the state of destination for consumption or use; (2) For business purchases, vendors can be expected to obtain the location of the purchaser, as they will have standard business motivations for acquiring that information; (3) When the purchaser is an individual and the location of the actual use or consumption is available, it will be employed, but, in its absence, the

billing address will be used; and, (4) When neither the location of actual use nor the billing address is known, a default "throwaround" mechanism will be employed, by which those sales will be assigned to a state based on proportions of sales with the sources known, and taxed at a single rate agreed to by the states. Currently under discussion is whether the default mechanism should be applied to sales of digital products to individuals. Some subcommitte members have proposed that all sales of digital products should be sourced to the state of the seller rather than attempting to identify or replicate the state of use.

Paull Mines reported that the work of the Scope Subcommittee has focused on ways of implementing whatever system the other subcommittees arrive at, with the options generally being either federal legislation or a compact among the states. Federal legislation could provide that, for those states that adopt the changes advanced, there could be an expanded duty to collect imposed on businesses, or further, for states that do not join in the simplified system, there could be penalties imposed, usually regarding those states' abilities to tax different types of remote commerce. These methods of implementation are not mutually exclusive, as states could proceed individually, or as a group in a compact, to implement the changes, while also pursuing federal legislation, which offers the advantage of less legal vulnerability, based on Congressional jurisdiction over interstate commerce.

Paull and others expressed the general state of sales tax administration and the importance of the work being done by the NTA Project. It was generally observed that states and business should continue working on these matters because, on the macro level, whether states want to change their systems or not, commerce is changing. It has been predicted that, by the year 2010, half of all retail stores will be closed. States will be forced to adapt. As a more immediate concern, the commission established by the Internet Tax Freedom Act will be studying these issues and could benefit from the work of the NTA Project.

Finally, attendees were encouraged to join in the efforts of the Project, starting with attendance at the next meeting of the Steering Committee in Washington, D.C., on November 19 and 20.

The discussion then turned to the three approaches to tax simplification currently being considered: real time tax administration, the base state approach, and a hybrid system.

Real Time Tax Administration ?

While this approach is characterized in the concept paper as a "broker contract administrative system," or a "third party collection system," during the meeting, the system was renamed "real time tax administration" by Paull Mines, to reflect that, under this system, a state would receive the information and, at least in theory, the tax payment required by a taxable transaction would be remitted as the transaction was occurring. Briefly, under this system, a third party—a private entity such as a credit card company or other enterprise that could arise to meet the demand—would become the entity responsible for collecting and remitting the tax due on a transaction. The premise of this approach is that, in electronic commerce, the vendor and purchaser do

not actually deal directly with each other, but rather, their contact is indirect, through an intermediary, such as an Internet service provider or credit card company. The goal would be to use that intermediary, referred to as a "broker" in the discussion, as the tax collection agent, who would contract with the state to perform this service for compensation, which would presumably cover the broker's risk of loss due to mistake and improper reporting. The working assumption of this approach is that software—perhaps along the lines of the UPC bar codes—would be developed, in conjunction with the states, that would, automatically and in real time, designate a transaction as taxable or not, depending on the information—such as a description of a product and a purchaser's exemption number—supplied during the transaction. The vendor would not be responsible for anything other than supplying accurate information to the broker.

It was noted that the technology to implement such a system already exists and is being used in lottery-ticket sales, which employ registers linked directly to the state office monitoring those sales.

The biggest problem noted with this approach was how to properly distinguish between taxable and exempt sales in the case of items that could be either taxable or exempt based on the status of the purchaser or the use to which the item is put. While that difficulty could be resolved by an assumption that software would be developed in conjunction with the states that would make that designation at the point of sale, such an approach received a skeptical reaction, especially in light of the problems that occur in transactions today, when there is direct contact between vendor and purchaser and it is clear what is being sold. Those problems could multiply when there is no contact between vendor and purchaser and it might not be clear what the item being sold is, as with a credit card purchase now, which would only indicate the vendor, but not the item.

Other speakers suggested keeping in mind that such problems with exemptions already exist and actually represent a small part of what is involved, and would be more than offset by the expanded duty to collect. Similarly, a potential problem with revenue estimating and forecasting could be offset by quicker collections.

Base State System

Briefly, under the base state approach to the administration of sales and use taxes, a company would be required to register and report and pay its taxes to only one state, the state in which its principal place of business is located. That state would then calculate the tax that was due it, keep that amount and distribute the rest to the other states to which it was owed—although such disbursement could be accomplished through a centralized clearinghouse which would forward only net balances owed to other states, when all companies are considered. There could be only single audits performed, either by the base state alone or in conjunction with other states, or by third parties. A central administrative agency would most likely need to be established to handle the coordination of payments and peer review, among other functions. And, a mechanism would have to be developed to assign companies located in states without sales taxes to other states.

Discussion about this approach was substantially informed by attendees' experience with the International Fuel Tax Agreement, with both positive and negative effects. The IFTA experience, which has been largely successful, indicates that there are possibilities to a base state system, but also advises that any problem with IFTA, which deals with essentially only one product that is sold in a fairly self-contained system, would be exacerbated in the context of sales and use tax collection, especially considering electronic commerce and sales of digital products.

One aspect of a base state system that the attendees believed would become particularly important was peer review, i.e., a methodology for determining that each state met its obligations to all others. For example, states would be concerned that other states exert the effort to perform audits and collect taxes that they themselves were exerting, to avoid the situation of a state letting other states collect its taxes for it, while doing little or nothing to collect and distribute taxes from companies for whom it was the base state.

To this end, it was pointed out that the process itself would have to be closely monitored. Audit standards would have to be established and maintained. Rules for when monies would actually be transferred, relative to appeals pending, would have to be established. Relative costs of audits would have to be considered, e.g., to account for certain states' being perennially saddled with large audits that produce large amounts of taxes for other states.

Hybrid System

Under the hybrid approach, a taxpayer would register, file and pay electronically at a central, single point, whether a central administrative agency or a base state, with that information then being routed to the states to which it relates, for those states to use then to their own ends within their own systems, as now occurs. This system presents the least radical change and the largest use of the existing systems, and could be employed as a bridge to a more radical change.

Speaking of which, a consideration relevant to any thought of implementing any of these approaches is the scope in which such change would be employed. That is, would the changes be applied to only electronic commerce, remote commerce, or all commerce? Would it be feasible to test a particular approach within only a single industry, the way IFTA is used for only motor fuels? One concern with such an incremental approach is that there would be at least a dual system of administration in place for the testing period, although that would necessarily be true with the real time approach, as only covered sales would be reported by the broker, at least until the system was expanded to include all commerce.

Evaluations

Following the discussions of each approach in general terms, the attendees were asked to assign letter grades to each approach under a variety of criteria, with each criterion to be evaluated in two aspects, as applied to remote commerce—i.e., commerce for which nexus does not now exist, for which tax is not now being collected—and to all commerce. Grades to be assigned ranged from F to A. The resulting evaluations will be

discussed below, by criterion.

Preliminary Notes

It should be noted that the evaluations of the three approaches were affected by a couple of general trends, as reflected in the grades given and the comments voiced. First, while the hybrid system is similar in many ways to the existing sales tax administrative system, and an evaluation of the base state system could be informed by experience with IFTA, the real time approach, being completely different from the current system, presents some uncertainty; this produced conflicting results, with some attendees consistently grading the real time approach poorly, while a somewhat larger group seemed to consistently favor it, presumably in comparison to the existing system.

Second, as noted above, each approach was graded twice under each criterion: once for remote commerce and then for all commerce. In almost every instance, the "all commerce" grade was lower than the "remote commerce" grade (there were some ties, but no instance when "all commerce" faired better). In discussing why this occurred, it was suggested that the new approaches were intended and designed to accommodate and adapt to the new challenges and opportunities presented by electronic commerce, and that it could be harder to modify existing systems to accommodate, in the first instance, electronic/remote commerce. However, the value of working to expand administrative simplifications to as many businesses as possible was noted. Thus, tax administratorss discussed how the process of change in tax administration would extend from the most technologically advanced operations, to other spheres of commerce. and all commerce than it would be to design a new system to accommodate just electronic commerce.

The tax administrators remain open to the concepts for change offered, but recognize that any change will necessarily require more than just the willingness to change, but also practical solutiosn that will take time and effort to implement. And, such systemic chaqnges as are bing discussed might also require gradual implementation, to ease the transition not only for tax administrators, but for bujsinesses as well. Any new administrative system should incorporate the most advanced technologies realistically available, which could reasonably be expected to more quickly accommodate businesses that are accustomed to dealing in those technologies; hthe new systems could then be adapted to include those less technologically advanced businesses at the same time that those businesses are moving toward adapting to the ntew system. These considerations highlight the importance of devising as smooth a transition to any new system as possible, with consideration to be given to a gradual process, perhaps applying a new approach to a restricted number of industries, and then allowing that toehold to be expanded to other areas.

The resulting evaluations follow, by criterion>

<u>Vendor convenience.</u> The clear winner under this criterion would be the real time approach, since, at least for covered sales, vendors would have no responsibility for filing returns or remitting tax, or anything else beyond providing accurate information to the brokers—although, at least until such a system could be fully implemented to cover all commerce, vendors would still have to file all the returns they now file for non-covered transactions. That the base state system scored slightly better

than the hybrid system may have been the result of a lack of clarity about the hybrid system and whether, under such a system, more than one return would have to be filed; and, even if only one return were contemplated under the hybrid system, vendors would still have to figure out exemptions for 46 states.

State Computer Systems. Generally viewed as determining how well the existing computer systems could be adapted to the new approaches—and apparently influenced by a general disdain for the operation of the existing systems—this criterion slightly favored the real time approach over the hybrid approach, with the base state approach finishing a distant third. Under the base state approach, existing systems would have to be modified substantially or completely rebuilt, to accommodate the movement of information to other states and the acquisition of new types of information, e.g., for transactions that a state does not currently tax. The hybrid system was seen as not requiring much change. There might have been some confusion in evaluating the real time approach under this criterion, as some viewed the approach as requiring a dual system of reporting, for covered and non-covered transactions, while others evaluated the approach as if it covered all commerce.

"Do-ability" (feasibility and timeliness of implementation). Predictably, the hybrid approach prevailed in this criterion, presumably because it would require the least radical systemic change and make the most use of existing operations.

Cash flows. The clear preference under this criterion was the real time approach, for, as its name implies, the tax would be paid at the time of the transaction. The base state and hybrid approaches present concerns about how well funds could be disbursed among states, and how long states that collect taxes could retain funds (for example, pending appeals), among other matters.

Ease of audit. Under this criterion, the real time approach prevailed slightly over the hybrid approach, with the base state approach a distant third. The hybrid approach was apparently viewed as the status quo in this regard, since states would continue to do what they now do with the information that is passed on to them, and the real time approach would be an improvement over the existing system since, at full implementation, there would be fewer entities to audit—the relatively small number of brokers—and all of the information would be electronic.

Collections of delinquent taxes. Under this criterion, the real time approach was given a full grade above the other approaches, apparently because base state and hybrid approaches bring into question what efforts states must go to to collect taxes. For example, one state's collection agency, the office of the state attorney general, is hardly aggressive with its own state's taxes due, and so would likely be even less so with another state's taxes, while another state jails delinquent taxpayers.

Obtaining information for compliance and policy. The hybrid approach prevailed under this criterion, presumably because it presents the least radical departure from the existing system. Under the base state approach, states requiring consolidated returns would be concerned that they would still get all the information they require, and the real time approach would present concerns about revenue estimating and forecasting, since covered sales would be removed from the existing

system—though, under the real time approach, more information would presumably be available more quickly, and electronically, though a new methodology would have to be developed to compile that information.

Protection of confidential information. The base state and hybrid approaches were given the same grades under this criterion, with the real time approach more than a full grade behind, since the real time approach allows for the handling of confidential taxpayer information by a nongovernmental third party.

Governance. Under this criterion, which relates to administrative and judicial proceedings such as appeals, the hybrid approach prevailed easily, presumably because that approach represents no change from the existing system in this regard. The base state approach finished a distant third, possibly due to problems presented by the IFTA system for appeals, which include having the courts of one state deciding questions of law of another state. The real time approach presents unknowns, such as how appeals would be handled, and the role of a central administrative body.

As to the grading itself, some general observations can be made:

- Regarding the remote commerce group, the real time approach prevailed in five of the nine criteria, and, in the "all commerce" group, the hybrid approach prevailed in five out of nine criteria.

- Most of the four areas in which the hybrid approach prevailed over the real time approach regarding the remote commerce group—do-ability, obtaining information, protection of confidential information, and governance—would seem to be areas in which a conservative approach, as indicated by protecting the status quo and avoiding the unknown, would be favored.

- There was no criterion under which the base state approach alone prevailed, although it did tie with the hybrid approach in the protection of confidential information.

MT, 11/12/98

G

Concept Paper
Base State Administration of State and Local Sales and Use Taxes[1]

Purpose
This paper is designed to provide an overview of the manner in which a "base state" filing and administration could be applied to state and local sales and use taxes and to identify some of the major issues that would have to be addressed in implementing such a system. It is intended to help guide discussion of the topic among states.

General Concept
The primary goal of the Base State System is to limit, to the maximum extent possible, a taxpayer's contact for sales tax administration and compliance purposes (whether for registration, returns, remittances, administration, audit or appeals) to a single state, (CONTRACTOR) presumably its principal place of business. The base state, in turn, becomes responsible for communicating information, transferring funds, performing enforcement and administrative functions, etc. on behalf of the taxpayer with other states participating in the agreement.

The base state concept has been successfully deployed for motor fuel use taxes imposed on interstate motor carriers. Each of the lower-48 states currently belong to the International Fuel Tax Agreement which is utilized to apportion fuel tax liability of interstate carriers among states in which they travel.[2]

Sales Tax Administration under a Base State System
This section of the paper reviews how a base state system might be applied to the various aspects of sales tax administration.

Registration. In a base state system, a vendor should be required to register with only the base state, generally the state in which its principal place of business is located. Information required on the registration form will need to be coordinated among states to insure that all legitimate information needs are addressed.

Potential Issues. Issues of interest to tax administrators include: (1) Whether a surety bond or other similar "protective resource" is required of taxpayers? (2) What sanctions can be taken against a vendor who is noncompliant in some fashion? [Given that a single registration will confer on a vendor the authority to operate in all states, sanctions against that authority will be of the utmost importance.] (3) What procedures

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[1] This paper draws heavily on the "Interim Report of the Filing Simplification Subcommittee" made the Steering Committee of the National Tax Association Communications and Electronic Commerce Tax Project in April 1998.

[2] Federal law provides that a state may impose an apportioned fuel use tax only if it participates in a base state administration system. IFTA is the only such agreement currently in operation.

and tools will be available for communicating information about the validity of registrations among states?

Returns. A vendor should be required to file a return with only the base state, but that return would need to include relevant data on the vendor's operations in all states for the reporting period. The base state would be responsible for providing the return information to other states. The uniform return would need to include agreed-upon information.[3]

Potential Issues. One complicating factor may be the desire/need to obtain information on exempt sales. Another complicating factor may be the manner in which it is determined that "direct pay" permit holders (discussed in more detail below) should be handled, *i.e.*, should the direct pay use tax be included on the sales tax return?

Remittances. A single remittance to the base state would be required, and the base state would be required to distribute those funds to all states in which the seller had a liability. The handling of money and getting it to all participating states would be handled by a National Clearinghouse, which is discussed in more detail below.

Additional Option. It is recognized that any new administration system must insure that all tax receipts are remitted to the states in a timely fashion so there is no loss of interest earnings or cash flow disruption. For that reason, consideration should be given to adopting a model for dealing with remittances that is employed by certain states that participate in the "Regional Processing Center" (RPC)[4] for IFTA. In the RPC, all returns of participating jurisdictions are "netted" against one another. A state needs only to make one funding remittance to the RPC to meet its obligations to all states instead of making a remittance to each jurisdiction. In a sales tax Base State System, a state would have to make only one payment (or receive one check) that is the net of all activities of all vendors in the state, rather than reconciling its liabilities with each state individually.[5] A "netting" function such as this both speeds the remittance of funds to

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[3] At this point, the working premise of the NTA project is that there will be only a single statewide tax rate applied to all sales. In addition, there will be no sourcing of sales to individual local units of government for tax purposes or reporting on collections at the substate level, i.e., information on sales and collections would be reported only at the state level.

[4] The RPC is a fuel use tax administration system developed by New York State so that it would be useable by any number of states in IFTA. At the present time, the RPC handles some or all of the IFTA returns and remittance processing for 18 jurisdictions, including two Canadian provinces. The system was designed so that a state could participate in all or parts of the processing system.

[5] In the RPC, this is accomplished in the following manner. Each participating state must submit a file to the RPC within a specified period of time after each filing period. The file shows the taxpayer, amounts due each state from the taxpayer and the amount paid to the state. On an overnight basis, the files from the various states are consolidated, and a netting summary is prepared. Each state is then provided with a notice of the amount it must fund to the RPC or the amount it is due from the other states. States with a net liability are given 24 hours to make their cash settlement. The RPC then provides funds to each state with a net receivable, and all accounts are reconciled. All payments and notices are done electronically through e-mail, EFT and electronic downloads/uploads of data.

states and reduces substantially the amount of paper and checks or electronic funds flowing among the states.

Potential Issues. It will be important to have clear, enforceable rules governing exceptions from the normal process, e.g., "partial pays," "no remits," nonfilers, late payments, etc. The fuel tax regime has detailed rules that should be helpful in this regard.

Taxpayer Service

With the consolidation of a many filing functions into a base state, a number of the taxpayer service functions would also be able to be handled in the same fashion.

Potential Issues. It would seem that questions of "taxability" or other questions of how the laws of an individual state apply to a seller or transaction should still fall to the state with the responsibility for interpreting the law. Tools for routing requests among states quickly and easily should be able to be developed.

Audits, Assessments and Appeals

Audits

The goal would be to propose a system that will permit one consolidated audit on behalf of all jurisdictions for each tax period. A single audit system could be implemented in either of two ways. One possibility is that the base state's audit agency would audit the vendor on behalf of all states. This option, referred to as the "Base State Audit," is the model generally employed in the fuel tax system. An alternative would be the "Outsourced Audit," where responsibility is contracted to a single organization to perform audits on a national basis for all states. The present MTC Audit program could provide a model for this system. In either case, the vendor would be relieved of the burden of multiple audits of the records for a tax period.

Potential Issues. To a considerable degree this is considered to be contingent on the "Scope" of the system, i.e., to what range of sellers and products is the system extended because that will be determinant of the complexity of the tax and audit.

Appeals

Presumably in a "pure" base state system, any appeal of an audit finding would be taken with base state. On the other hand, in any adjustment involving an interpretation or application of the law of a second state, it seems more reasonable (and in fact necessary for control of the tax policy of the second state) that such an issue should be appealed and adjudicated in that state. This is the model followed with MTC joint audits.

Re-audits.

The suggestion is made by government representatives that there will be some cases where it is necessary to allow states other than the base state to examine working papers and conduct re-audits. The business representatives are opposed to this concept, since it defeats the purpose of having a single audit. Further debate is required on this point.

Other Administrative Matters

Central Administrative Agency

As is the case with the new fuel tax system, it will likely be necessary to have some central administrative entity as part of the new Base State sales tax system. At a minimum, the duties of this entity would include: (1) administering the peer review program (necessary to assure states that each is faithfully meeting its audit obligations; (2) providing interpretations of any organizing documents establishing the system and defining the rights and obligations of both vendors and states; (3) coordinating the selection and conduct of audits; (4) operating the funding process and other information processing systems; (5) maintaining any tax compliance software employed by vendors; and (6) developing, refining and insuring adherence to the various uniformity requirements of the new system.

In the case of the International Fuel Tax Agreement, IFTA, Inc., a dedicated not-for-profit corporation controlled by all the states, plays this role. The procedures for governance and operation of this entity are quite lengthy and specific, and could serve as a model for a base state sales tax system.

Direct Pay

A base state system will need the ability to deal with direct pay taxpayers. Direct Pay is especially useful for purchases of information services and other intangible products that may be downloaded or maintained at a single location for later use in multiple jurisdictions. It also has expanded applicability in a number of other areas.

Potential Issues. Our questions will include the following: (1) do Direct Pay taxpayers register with only a single state; (2) do they file with a single state; and (3) is there a separate system for Direct Pay taxpayers or are they "folded into" the sales tax Base State System. In other words, just about every question asked for a sales tax vendor is also applicable to a Direct Pay permit holder.

Vendors Based in States with No Sales Tax

There will also need to be a means to deal with vendors based in states without a sales tax. These vendors should not be "orphaned" by a Base State System and required to deal with multiple states. They could be "adopted" by some other state for purposes of the Base State System, or they could be assigned as a responsibility of the central administrative entity.

H

Hybrid Base State Proposal

What follows is a hybrid, base state proposal. The proposal is limited to a single point interface of the front end aspects of administering the multistate sales and use tax system. Front end aspects are limited to (i) electronic registration and all of the official responses that flow from this act; (ii) electronic tax return filing, and (iii) electronic tax payment. The hybrid approach may appeal to States, because every State may process its own taxpayer data once it is received from the central filing point and issue its own documentation.

The hybrid proposal contemplates the taxpayer being able to register, file and pay electronically at a single point. The base state would not crunch the files that would be received from the single point communication. Rather the defined fields of each multistate taxpayer communication would be routed to the appropriate state specific processing points for appropriate action by that State.

To illustrate the system, consider the registration process. There would be a single registration form that assembles in one place all the questions necessary to secure the information required by all States in order to register under the various sales and use taxes. In developing this registration form, some effort would be made to encourage States to ask for the same material in the same manner, but it would not prevent the unified registration process to work if some uncooperative State insisted on doing it, "my way." The taxpayer would complete the registration electronically and file it with the base State, or perhaps a central filing point. The receiving point would process the filed data and send pertinent data fields to each of the various States for which the taxpayer sought registration. The receiving States would each receive the data and process it through their own systems to issue the registration that would pertain to the taxpayer and that State. Because the data being received is text, there should be little challenge to placing the various data fields into the appropriate processing sequence to issue the necessary responses.

Similar processes would work in filing tax returns and making tax payments.

The chief advantage of the hybrid system is that the taxpayer secures a virtual, "single point system of sales and use tax administration," but each of the States still processes the data individually to meet their own requirements. The processing occurs on the top of the state data processing systems, before the data is entered into the state specific processing procedures. Because the interstate module interfaces at the

top and is limited to text, each State proceeds without having to do massive changes to their systems. Even a State that lacks data processing can operate this system by simply processing the received data into a hardcopy document from which the normal state adminstrative processing occurs. Quite frankly, maybe because it is late in the day, there appears to be no disadvantages to the hybrid system other than perhaps it does not go far enough. But realistically, state cooperation must proceed incrementally and build sound foundations and trust for going further. Rational persons will only choose the hybrid system if they have their heart in the right place which is far from Yankee Stadium in the Bronx.

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NATIONAL TAX ASSOCIATION
11/98 I

Concept Paper: Real Time Tax Administration
Administrative Simplification of Sales Taxes for Electronic Commerce

Description:

"Real time tax administration" is one major approach to the simplification of sales taxes for electronic commerce transactions.[1] The primary idea underlying this approach is that the technological features of electronic commerce can themselves be the basis for efficient tax administration. Vendors sell by electronic means through the use of "brokers": communications or online service companies, software providers, and credit card or electronic cash companies. On a real time basis, these brokers route and parcel information and payments in electronic commerce so that transactions can be completed. Real time tax administration would simply add the simultaneous routing of tax information and payments to the process of electronically-facilitated transactions.

Under real time tax administration, vendors for electronic commerce transactions could be required to ensure that their sales into a state are handled by one or more brokers on contract with the state for collection of that state's consumption taxes. The actual collection of taxes would be made by brokers at the time electronic commerce transactions occurred. The brokers would perform this service under contract to states and would be subject to audit by the states.

Operationally, these contractors would "embed" state and local sales tax requirements into the software used to conclude transactions over the Internet. Brokers would transmit tax return information and payments to states on either a frequent periodic (daily) basis or even continuously as transactions occur.

Vendors would file no tax returns and would not be subject to any audits or tests other than those necessary to ensure that they are making sales through brokers collecting state and local taxes.

The scope of this system would be such that it would handle, at a minimum, all sales made through the Internet or online services. It could also handle credit or debit card sales made in traditional stores and by direct marketers where those stores and direct marketers are using electronic systems. In these cases, vendors would be relieved of filing tax returns and making payments for "covered" sales. Vendors might initially continue to be responsible for filing returns and making payments for "non-covered"

[1] "Real time tax administration" appears to be similar if not the same as an "escrow agent system" advocated by Presidential advisor, Ira Magaziner. The general notion behind these ideas is that parties that are strategically located in the operation of the Internet be paid by governments to collect taxes as a financial service. Another term for such an arrangement would be "third party collection" system.

sales: those made by cash or check.[2] Eventually all transactions could migrate to real time tax administration.

Tax information and payments would flow directly from electronic systems maintained by the brokers into electronic state tax systems. State tax systems would need to be capable of receiving the information and payment from brokers. A choice would also need to be made as to whether the broker would submit information aggregated at the broker level only or whether vendor-specific information would also be provided. If no vendor information was provided at the time of filing and payment, the brokers could maintain vendor specific records that states would review periodically in their performance and financial audits of their brokers on contract.

"Real time tax administration" would be an all-electronic system. Ideally, it would constitute a nearly seamless link from the point of a transaction to the point of input into state accounting and payment systems. Information and payments would stop along the way only long enough for verification and to clear whatever hurdles exist within the global network of electronic financial systems.

Similarities and Contrasts with Current Administrative Systems

Real time tax administration contains several similarities with current administrative systems. First, real time tax administration retains the current practice of having a "taxpayer" provide information and payments to each individual state. The only difference is that the taxpayer in this case is a broker instead of a vendor. This means that as long as state tax systems are able to accept electronic input the changes in state automated systems should be minimal. Further, because return information and payments go directly to each state, there is no need to build new systems to move information and payments from one state to another.

Second, conceptually real time tax administration essentially duplicates in electronic commerce the most common method of collecting sales taxes in traditional commerce: at a checkout counter in a store when a transaction occurs. The electronic counterpart of the store checkout counter occurs when electronic order and payment information is brought together. Most likely, that is at the point when an order is being charged to a credit card or e-cash account. Thus, financial intermediaries are among those parties that would qualify to provide the tax collection function. Transaction taxes are collected most efficiently at the time of a transaction. If taxed later after the transaction information and payments have separated from each other, administrative costs of tax collection usually increase. Hence, real time tax administration attempts to accomplish

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[2] Conceivably, even these transactions could be handled through the "broker contract system." In these cases, vendors would simply be subject to paying the brokers, presumably electronically, the additional tax for cash and check transactions.

collection at the time an electronic commerce transaction occurs, just as is the case with traditional commerce.

One major difference under this system as compared to current tax administrative systems is that the broker substitutes for the vendor as the taxpayer. There are several implications of this change. First, the number of taxpayers will likely by much smaller than if all electronic commerce vendors submitted information directly to states. Second, an issue arises as to whether the broker "taxpayer" should submit with tax returns detailed, vendor-specific information, or whether information at the broker level is sufficient. Third, because brokers receive only a fraction of the revenue from a transaction, it is most reasonable to contract for the brokers' services. This requires the establishment of contractual relationships between states and brokers. It also requires an enforcement mechanism to ensure that all electronic commerce sales into a state are handled through tax collecting brokers. Finally, an additional issue arises as to how and to what degree vendors would be able to check on the accuracy of the tax being applied to their sales, even though the contractual responsibilities run from the broker to the states.

Real time tax administration would add some diversity to sales tax administration. However, it is important to note that the sales and use tax system already operates through two different processes: sales and use taxes collected at the time of transactions and use tax returns and payments filed subsequent to transactions, including direct pay systems by purchasers. Real time tax administration would, at least initially, not cover all transactions. It would begin with purely electronic transactions and, on an optional basis, with store transactions using credit or debit cards. If efficient and successful, the system would eventually cover all credit and debit card transactions in stores or elsewhere. As indicated in footnote 2, it is conceivable that vendors might pay brokers to handle cash and check transactions also, but that should not be considered a requirement at the outset. Thus, real time tax administration may or may not completely eliminate vendor collection, filing and payment of sales and use taxes. To the degree that traditional filing continues for cash and check transactions, real time tax administration adds a new variant to the sales tax administrative process.

Feedback Report on Administrative Alternatives

	Criteria	Base State System: Impact on transactions which currently have nexus	Base State System: Impact on transactions which currently have no nexus	Hybrid System: Nexus	Hybrid System: No nexus	Real Time System: Nexus	Real Time System: No nexus
1	Scope of transactions covered.	all commerce	all commerce	all commerce	all commerce	some but not all sales, initially limited to electronic commerce	some but not all sales, initially limited to electronic commerce
2	Vendor convenience.						
	a. cash sales	very simple -- vendor need only deal with a single agency	n/a	too complicated -- vendor must still have direct contact with 50 agencies for adjustments, audits, appeals and exemptions	n/a	not useful	n/a
	b. check sales	very simple	very simple	too complicated -- vendor must still have direct contact with 50 agencies for adjustments, audits, appeals and exemptions	too complicated -- vendor must still have direct contact with 50 agencies for adjustments, audits, appeals and exemptions	possibly useful, but will not be available until a system is pioneered in electronic commerce	possibly useful, but will not be available until a system is pioneered in electronic commerce
	c. credit card sales	very simple	very simple	too complicated -- vendor must still have direct contact with 50 agencies for adjustments, audits, appeals and exemptions	too complicated -- vendor must still have direct contact with 50 agencies for adjustments, audits, appeals and exemptions	helpful if vendor can transfer legal liability to the broker	helpful if vendor can transfer legal liability to the broker
	d. business account sales	n/a -- direct pay	n/a -- direct pay	n/a -- direct pay	n/a -- direct pay	n/a -- direct pay	n/a -- direct pay
3	Adaptability to inbound international sales.	n/a	easiest to enforce b/c export sellers outside the U.S. must only register in one place	n/a	too complicated -- vendor must still have direct contact with 50 agencies for adjustments, audits, appeals and exemptions	n/a	very helpful, but don't see how its use could be enforced
4	Compatibility with state fiscal requirements.	??	??	??	??	??	??
5	Impact on computer systems.						
	a. state agency systems	??	??	??	??	??	??
	b. business systems	would save $$	would save $$	would save $$	would save $$	probably too expensive	offers an attractive alternative for small vendors
6	Consumer convenience.	no impact	no impact	no impact	no impact	no impact	no impact
7	Consumer privacy.	no impact	no impact	no impact	no impact	exposes data to an additional private contractor, and may require waiver of privacy rights	exposes data to an additional private contractor, and may require waiver of privacy rights
8	Other factors (specify)						
	a. adaptability to "destination" sourcing regime	acceptable	acceptable	too complicated -- vendor must still have direct contact with 50 agencies for adjustments, audits, appeals and exemptions	too complicated -- vendor must still have direct contact with 50 agencies for adjustments, audits, appeals and exemptions	very simple, but would not replace traditional compliance systems	very simple, but would not replace traditional compliance systems
	b. adaptability to "origin" sourcing regime	very simple	n/a	better, but still complicated -- vendor must still have direct contact with agencies of all states in which it has nexus	n/a	may not be cost-justified	may not be cost-justified

Submitted by: Ken Silverberg
11/12/98

National Tax Association Communications And Electronic Commerce Tax Project

Organizing Documents (OD-15) STATEMENT OF POSITION OF THE BUSINESS GROUPS

STATEMENT OF POSITION OF THE BUSINESS GROUPS

January 13, 1999

In response to the request of the government group members of the NTA Tax Project, the business group members have prepared the following list of proposed policies for use by the Project in continued dialog. While a majority of the business representatives support this proposal, the support for each and every line item may not be unanimous. And, due to time constraints, some business group members have not yet been able to consult with their constituencies regarding some or all these principles.

In order for the business groups to consider supporting a proposal which includes an expanded duty to collect sales and use taxes by remote sellers, the following measures must be included in the proposal:

I. THE POLICIES DESCRIBED IN THIS PROPOSAL APPLY TO ALL VENDORS (I.E., NOT LIMITED TO ELECTRONIC COMMERCE VENDORS.)

Sales and use tax reform should be extended to all forms of commerce, and not be limited to only electronic commerce. The benefits derived by both business and government groups from a new and improved sales and use tax system will clearly benefit all participants in commerce. Further, broadening the scope of this Project will, in many ways, reduce the obstacles facing the Steering Committee. For instance, the importance of determining the definition of electronic commerce will be negated. Therefore, the Project's solution to improving the current sales and use tax system should be extended to all forms of commerce.

II. TOTAL SIMPLIFICATION OF SALES AND USE TAXES SHOULD BE IMPLEMENTED

The Project's work product must represent a simplification of the current sales and use tax system. The business group members have termed the level of simplification necessary to reach agreement as "Total Simplification." The components of Total Simplification follow:

A. <u>DEFINITIONS</u>

1. Absolute uniformity among the states regarding the definition of relevant terms and concepts. A "glossary" will be developed and operative language in all state and local statutes and regulations regarding sales and use tax will utilize the terms as

defined in the glossary. Defined terms will, at a minimum, include: "telecommunications," "tangible personal property," "intangible property," and "various services" (and classifications of same, such as "data processing").

2. Uniform categorizations of products and services, and an analysis of whether and how each state taxes each category. States will jointly develop and provide this information in an electronic form suitable for use with sales and use tax software programs.

B. UNIFORMITY AND SIMPLIFICATION OF SALES TAX STRUCTURE

3. Absolute uniformity is the ideal outcome of the efforts of this Project. Uniform acceptance and application of any new system will likely require implementation of the system or rules by federal legislation.

4. A single sales and use tax rate will be set by each state.

5. Telecommunications services should not be subjected to higher or additional transaction taxes than other goods and services. Each state's state and local transaction taxes on telecommunications should be consolidated into the single, statewide transaction tax, reportable to a single remittance point in each state.

6. Uniform, multistage registration forms and requirements will be developed (i.e., national registration form).

7. Uniform effective dates. The effective date for tax rate changes (or other statutory changes) will be limited to January 1 and July 1, with a minimum six (6) month notice period of any tax changes.

8. Bad debts. A bad debt deduction and other provisions (e.g., handling of bad checks, etc.) will be provided to vendors and assignees who do not collect amounts due in taxable transactions with respect to which tax has already been remitted.

9. Uniform direct pay permit rules and registration requirements will be provided.

10. Uniform refund claim forms and procedures will be provided.

11. Uniform resale certificates will be provided.

12. Vendor safe harbors and reliance on customer-provided information. Certain presumptions, rebuttable only upon a showing of bad faith by the vendor, will arise to protect vendors who follow approved procedures regarding:

    a. customers paying by check,

    b. resale exemption certificates, and

    c. transaction sourcing information provided by customers.

    A uniform mechanism which is non-punitive to vendors will be developed for dealing with purchases by customers who decline to voluntarily provide

information.

13. Uniform exemption for shipping and handling charges will be provided.

14. A de minimis threshold for sales and use tax reporting will be established.

15. Uniform provisions for audits, assessments and appeals. These will include audit procedures, sampling methods, statutes of limitations and provisions for mitigation thereof.

C. RETURNS AND FILING

16. If tax returns are to be used for some or all taxable transactions:

    a. a national uniform sales and use tax return will be developed,

    b. a single national filing and remittance point will be employed (such as the one used under the International Fuel Tax Agreement),

    c. taxpayers will have the ability to file and remit electronically (EFT) through a uniform national mechanism, and

    d. sales and use tax returns will be required no more frequently than quarterly.

17. If a "real time" system is to be used for some or all taxable transactions:

    a. it will enable the automatic electronic collection, remittance and credits of tax at the point of sale, and

    b. no tax returns will be required to be filed for any sales subject to such a "real time" system.

III. VENDORS SHOULD BE COMPENSATED FOR THEIR COSTS INCURRED IN COLLECTING AND REMITTING SALES AND USE TAXES AS AGENTS OF THE STATE

Vendors will be provided a meaningful merchant's discount, with no maximum or cap. As agents of the state who incur substantial costs associated with collection and remittance of sales and use taxes, vendors are entitled to appropriate reimbursement of those costs. Three percent (3%) of tax collections appears to represent a fair amount based on the limited research performed to date.

IV. UNIFOR SALES AND USE TAX SITUSING AND SOURCING RULES SHOUD BE ADOPTED

1. Destination based system. Vendors will be required to collect and remit tax based on the destination state when that is known. A uniform national default rule will be employed where the destination state is unknown or when there is indication that the object of the transaction is a gift being shipped directly to the donee by the vendor.

2. Wireless sourcing. Wireless telecommunications will be sourced in conformance with the concepts included in the Wireless Tax Group's "Uniform Sourcing Proposal."

V. PHYSICAL PRESENCE SAFE HARBORS SHOULD BE ADOPTED FOR BUSINESS ACTIVITY TAX NEXUS

Sales and use tax nexus, or the duty to collect sales and use taxes, cannot be examined in isolation. There undoubtedly will be "spillover" and other tax nexus will be affected. Even the most substantial "firewall" cannot prevent the perception that income tax nexus is affected by an expanded duty to collect sales and use taxes. Furthermore, nexus issues are not limited to sales and use taxes; all types of taxes and taxpayers will benefit from clarification of the nexus rules.

It should be made clear that the following do not create nexus:

1. Electronic contacts or signals (wire, wireless, broadcast, internet, etc.)

2. Temporary (less than 30 days) presence of employees or owned or leased property.

3. Coverage of news and other media events of public interest (without regard to the duration of in-state presence.)

4. De minimis presence (expressed in both minimum numbers of employees and minimum value of owned or leased property.)

5. Apparent agency inferred from the conduct of independent contractors and other 3rd parties. (I.e., there should be no attributional (agency) nexus unless there is actual agency under state law.)

6. Presence of quality control inspectors at suppliers' sites.

7. Exploitation or other use of trademarks, tradenames, patents and other intellectual property in a state by an out-of-state taxpayer.